



The real value of investing in income

2008



The secret to income investing is understanding there are many available alternatives with different levels of risk and return.

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The variety and complexity of options can make it hard to determine the best type of income asset for you.

Investing for income

Investing for income is more complicated than it seems. Today, there are many income alternatives with different levels of returns and associated risks. The variety and complexity of the options can make it hard to determine the best type of income asset for you.

Many investors think all income assets are capital stable. This is not the case. Traditional income assets like bank accounts, term deposits and government bonds are very secure – but not all income assets are equal.

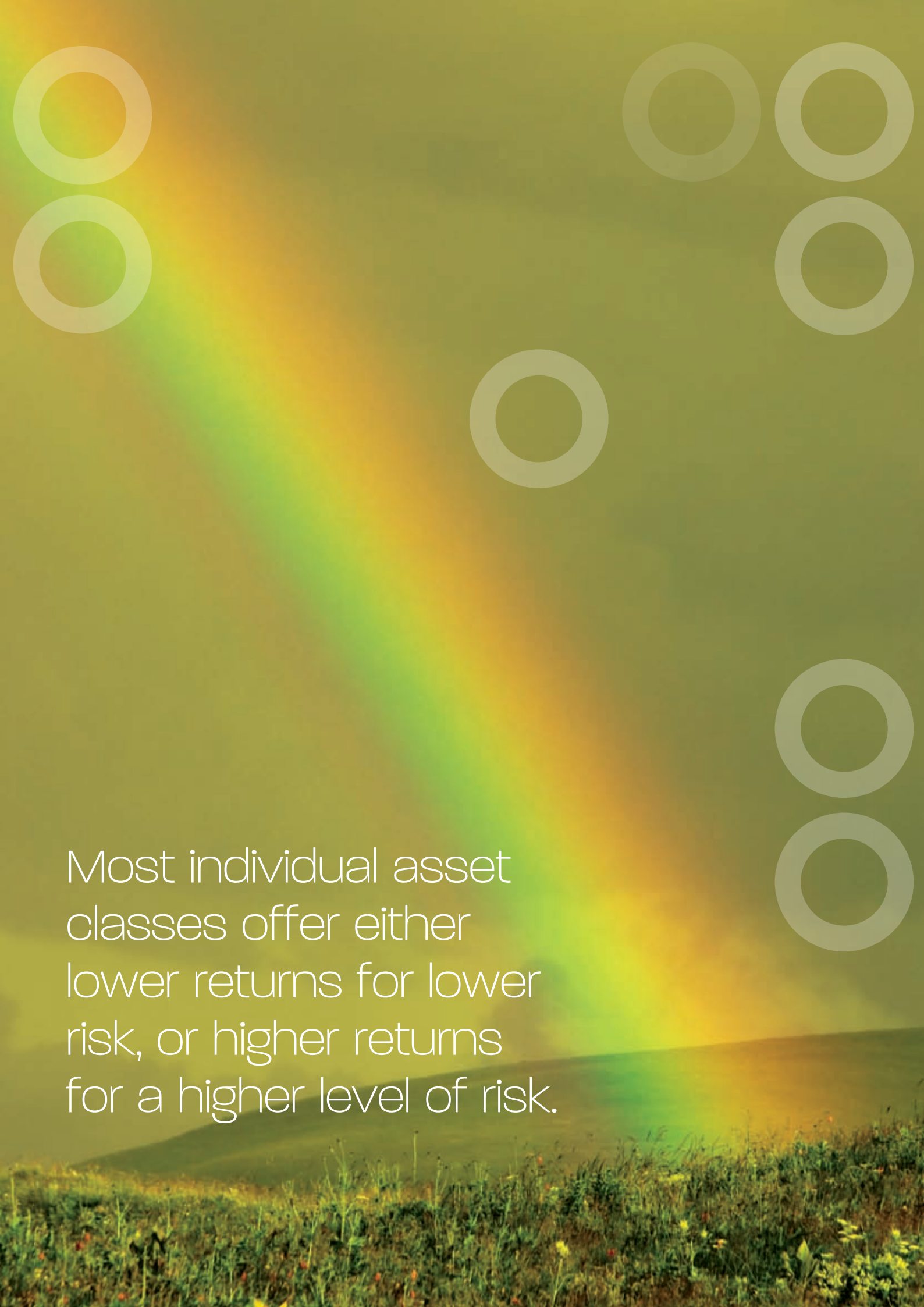
More intricate types of income assets have become available with the growing demand for income. Examples are collateralised debt obligations, mezzanine debt and hedge funds. These assets have the potential to deliver higher returns, but higher returns generally mean higher risk.

Figure 1 shows some of the types of risk you could face when investing for income.

Figure 1 – Some risks of investing

Risk	Description
Interest rate risk	The risk that interest rate changes affect the capital value of your investment.
Credit risk	The risk that the issuer defaults on interest payments or is unable to repay your capital.
Inflation risk	The risk that inflation undermines the performance of your investment.
Liquidity risk	The risk that you can't access your money when you need to.
Investment risk	The risk that the value of your investment falls, so you receive less than your original investment when you withdraw. Also, the risk that the distribution from your investment is lower than you expected or there is no distribution at all.
Asset risk	The risk that an asset within a managed fund falls in value, which causes a reduction in the value of your investment.
Derivative risk	A derivative is a financial instrument that derives its value from the price of a physical security or market index. The risk is that losses may happen when there is an adverse movement in the asset that underlies the derivative.

Source: Perpetual, Finsia



Most individual asset classes offer either lower returns for lower risk, or higher returns for a higher level of risk.

The spectrum of income assets

When you invest in income assets, you receive a return in the form of a yield.

In general, yield is an investment's annual income expressed as a percentage of its market value. With bonds, yield is the rate of coupon paid. With stocks, yield is the rate of income a stock generates in the form of regular dividends.

The yield of one type of investment can be compared to the yield of another to measure a component of return. Higher yielding investments generally have higher risk associated with them.

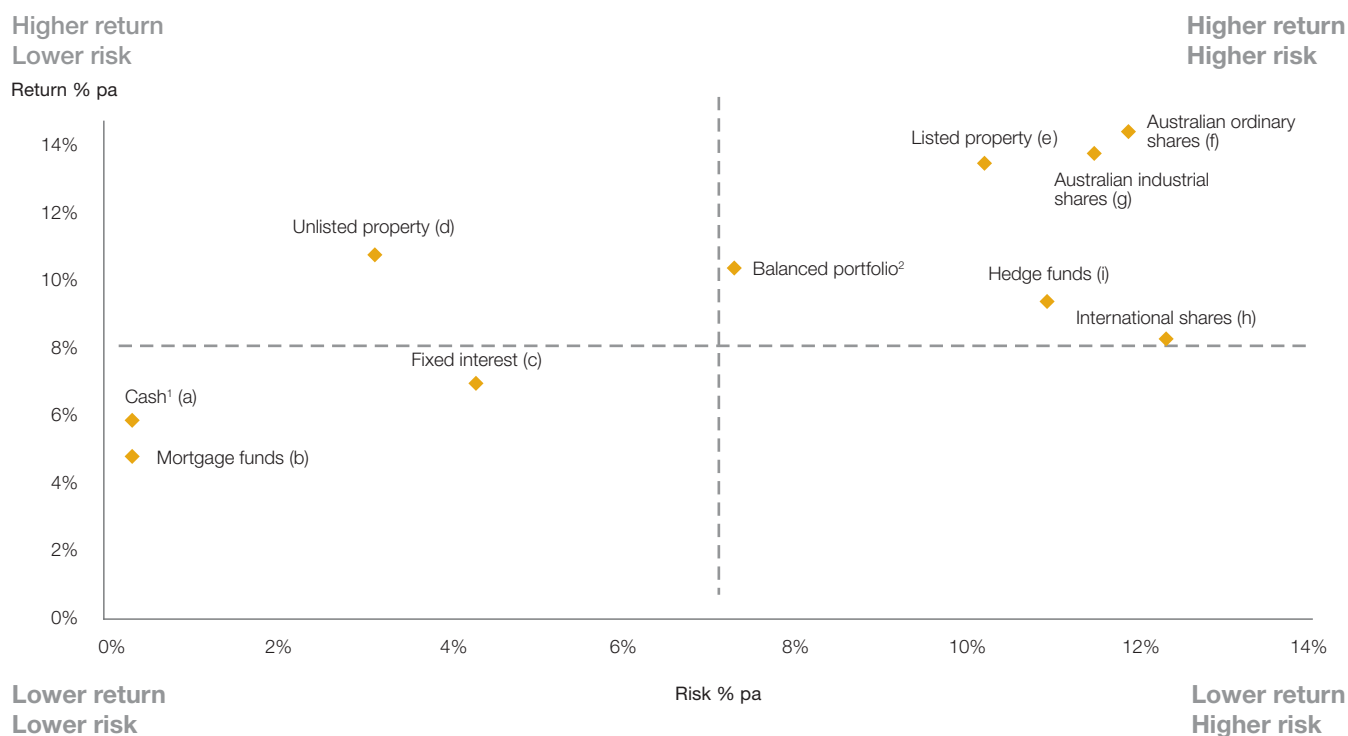
Many investments, such as property and shares, can provide both income and capital growth.

The risk and return of different asset classes are shown in Figure 2 below. Risk in this figure is measured by the volatility of the return.

You can see from Figure 2 that most individual asset classes offer either lower returns for lower risk, or higher returns for a higher level of risk. For example, cash and fixed interest generate lower overall returns for a lower level of risk. Compare these to hedge funds, which are a newer class of assets, and have a higher risk and higher return.

A balanced portfolio is spread across a number of different asset classes. It can help you manage risk as it's rare for all asset classes to perform poorly at the same time.

Figure 2 – Risk and return of different asset classes
15-year annualised risk and return to 31 December 2007



Source: Datastream, Morningstar, Reserve Bank of Australia, Credit Suisse/Tremont. Past performance is not indicative of future performance.

1. Cash includes bank accounts, cash management trusts and term deposits.

2. Balanced portfolio is made up of cash 10%, fixed interest 20%, property securities 5%, Australian shares 40%, international shares 25%.

(a) As measured by the UBSA Bank Bill Index (b) As measured by the Morningstar Mortgage Trust Index (c) As measured by the UBSA Composite Bond Index

(d) As measured by the Mercer Unlisted Property Trust Accumulation Index (e) As measured by the S&P/ASX 300 Property Trust Accumulation Index

(f) As measured by the S&P/ASX 300 Accumulation Index (g) As measured by the S&P/ASX 300 Industrials Accumulation Index (h) As measured by the

MSCI World (ex Australia) Accumulation Index in A\$ (i) As measured by the Credit Suisse/Tremont Hedge Fund Index in A\$.

The different sources of income

There are a range of traditional investments which generate an income return. Some examples are term deposits, cash management trusts, property and shares (Figure 3). However, several newer types of income-producing assets have surfaced to meet investors' growing need for income (Figure 4).

The growth of income assets has reflected businesses wanting to diversify their capital base and raise funds in global capital markets. At the same time, in a stable economic environment,

yield-hungry investors have increased their demand for market debt instruments that yielded more than government or semi-government bonds.

These newer assets have their own characteristics and risks and you should be fully informed about them before you make a decision to invest.

Key – Relative level of risk



Figure 3 – Traditional sources of income

	Investment	Definition	Relative level of risk
Cash	Bank account	An amount of your money held by a bank for safe custody. Effectively, the bank is borrowing money from you and will pay you interest in return. A bank account lets you deposit and withdraw money as needed.	★
	Cash management trust (CMT)	A type of managed investment that invests mostly in cash securities. CMTs can potentially offer a higher return than bank accounts.	★
	Term deposit	A deposit held by a bank or other financial institution for a fixed term. They generally have short-term maturities ranging from a month to a few years. Your money can only be withdrawn after the fixed term has ended. This means the bank or lender will generally pay a higher interest rate compared to a bank account where funds can be withdrawn on demand.	★
	Mortgage fund	A managed fund that receives your money and uses it to invest in mortgages. You then receive the interest payments on those mortgages, after the manager deducts fees and expenses. These mortgages are generally secured over commercial properties in the retail, office, industrial or residential sectors.	★★
	Bank bill	A cash or short-term instrument issued to investors by major banks. It will pay interest (a periodic coupon) plus the principal at maturity, which is normally up to 90 days.	★
Fixed interest	Bonds	A tradable instrument issued by a borrower to raise capital. The issuer promises to pay you a certain amount of interest over a specific time period, with the principal to be repaid on the maturity date. Bonds pay either fixed or floating interest, known as the coupon. As interest rates fall, bond prices rise and vice versa. There are three types:	
		▪ Government bonds. Issued by the Commonwealth Government in the Australian market.	★
		▪ Semi-government bonds. Issued by State Governments.	★
	▪ Corporate bonds. Very similar to government bonds except that a company backs the security instead of the government.	★★	
	Private debt	Investment opportunities not available in the public debt capital markets, normally from projects or corporations and involving non-standard features. It is often used to diversify risks and enhance returns in a portfolio of debt investments. Private debt can be complex, difficult to access and may not be transparent.	★★★★
Property	Listed property trusts (LPTs)	A collective investment vehicle that owns a portfolio of property. LPTs are quoted on the Australian Stock Exchange, allowing you to buy an interest in a professionally managed portfolio of commercial real estate. Property trust managers invest in properties across a diversity of geographic regions, with varying lease lengths and tenant types.	★★★★
	Direct/unlisted property	A vehicle that holds a portfolio of direct property assets. Income is usually quite stable, and opportunities for refurbishment or expansion of the asset may provide you with capital gains. As it is a longer term investment with valuations typically occurring annually, it generally provides returns with lower volatility than listed property. Unlisted property isn't listed on the sharemarket so it isn't directly influenced by movements in equity markets.	★★★★
Shares	Company shares	When you buy shares you become a part-owner of a company and share in the future profitability of that company. Shares can provide regular income through the payment of dividends and may also provide capital growth through increases in the share price.	★★★★

Source: Perpetual, Finsia

Figure 4 – Newer sources of income

Investment	Definition	Relative level of risk
Hybrid	<p>Combines two or more financial instruments, generally with both debt and equity. An example is a convertible bond, which is a bond that can be converted into equity, usually at the bondholder's discretion.</p> <p>Hybrids are diversified sources of income, with low volatility and low duration (duration measures the sensitivity of the price of an interest rate instrument to a change in interest rates).</p> <p>At times, high demand for hybrids can force their pricing up. They are unsecured and the debt can be deeply subordinated. Subordinated debt is unsecured or lower priority than that of another debt claim on the same asset.</p>	★★★★
Structured credit eg Collateralised debt obligations (CDOs)	<p>A broad term for credit related instruments, including CDOs, asset-backed securities and credit derivatives. CDOs are bond-like securities that bundle the cash flows from a pool of assets and pay them on to investors. The CDO is broken into 'tranches' which have claims on the cash flows and principal in sequential order, giving them different ratings and risk/return profiles. For example, the lower tranches absorb any losses of principal and income before higher tranches. In return, they earn a higher margin. The leveraged tranche structure often provides higher yields than a similarly rated corporate investment.</p>	★★★★★
Mezzanine mortgages	<p>Property loans (usually backed by commercial property) that rank behind the first-registered mortgage. The loan to valuation ratio for the loan might be as high as 95%.</p>	★★★★★
Hedge funds	<p>Use advanced investment strategies such as leverage, short-selling and derivative positions in both domestic and international markets.</p> <p>Hedge funds seek to provide consistent annual positive returns in both rising and falling markets. Returns aim to be independent from movements in other asset classes.</p>	★★★★★

Source: Perpetual, Finsia

It's important to note how inflation erodes your purchasing power



	Milk	Bread	Beer	Car
1970	\$0.25	\$0.21	\$0.22	\$2,967
2007	\$3.68	\$3.34	\$2.68	\$36,790

Source: ABS Data cube 6403.0.55.001, www.holden.com.au. Prices based on cost in Sydney.

Inflation

In the same way that inflation erodes your purchasing power, it can also eat into the return of your investments. Even if your investment's return is positive, if it is less than inflation it represents a loss of value.

Throughout most of the twentieth century and up until the 1950s, inflation was quite low. However by the end of the 1960s, the rate of increase in prices was growing.

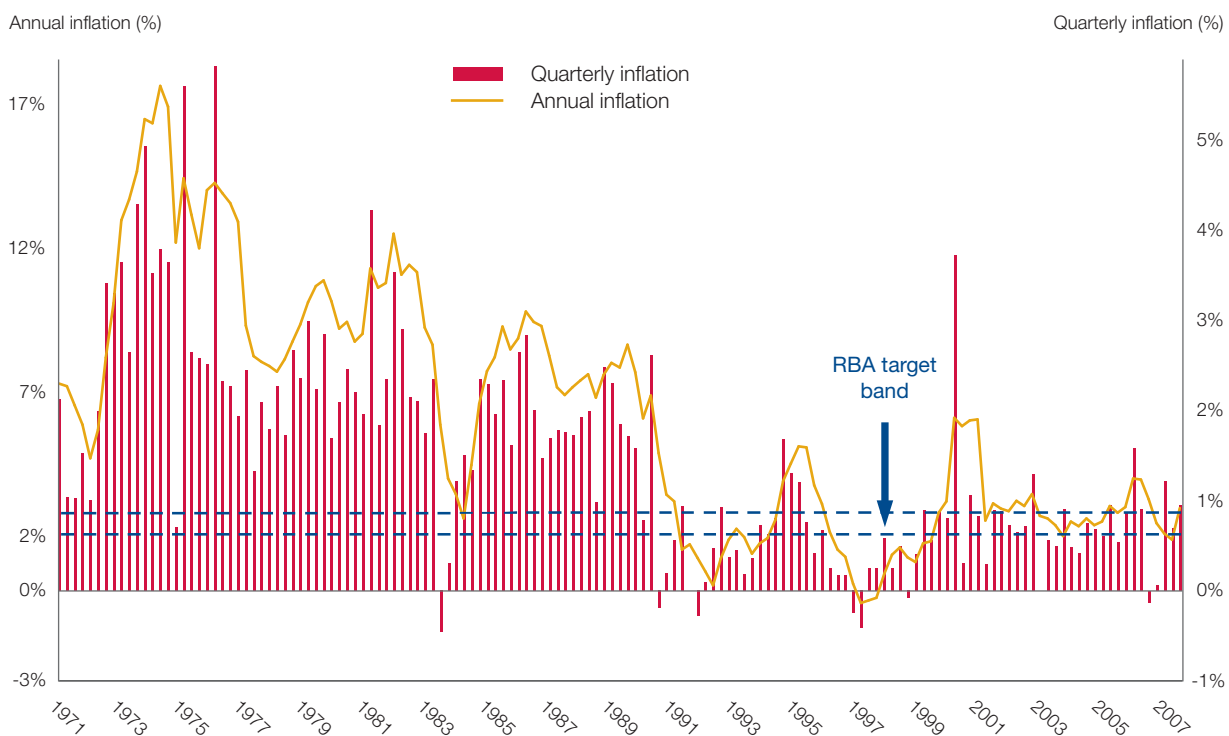
The oil crisis in October 1973 pushed prices to highly inflated levels. By the mid-1970s, annual inflation was much higher than today. Figure 5 shows the movement of inflation in Australia since 1971.

In the early 1980s there was a recession that brought inflation back down. However, following an economic recovery and large depreciation of the Australian dollar that pushed up the prices of imported goods, there were again inflationary pressures by the mid- to late-1980s.

After two decades of high and volatile inflation, it was in the early 1990s that the Reserve Bank of Australia (RBA) introduced an inflation target of 2-3% for monetary policy in Australia. The idea was, and is, that price stability is crucial for sustained growth in economic activity and employment. Since then we have been in a 'low inflation era', although recently there has been a re-emergence of inflationary pressures.

Bonds (and other types of assets) are being currently priced on expectations of continued long-term low inflation as a result of the RBA's 2-3% inflation target.

Figure 5 – Inflation in Australia



Source: RBA Bulletin Tables F13 and G2. From 31 December 1971 to 31 December 2007.



Australian interest rates

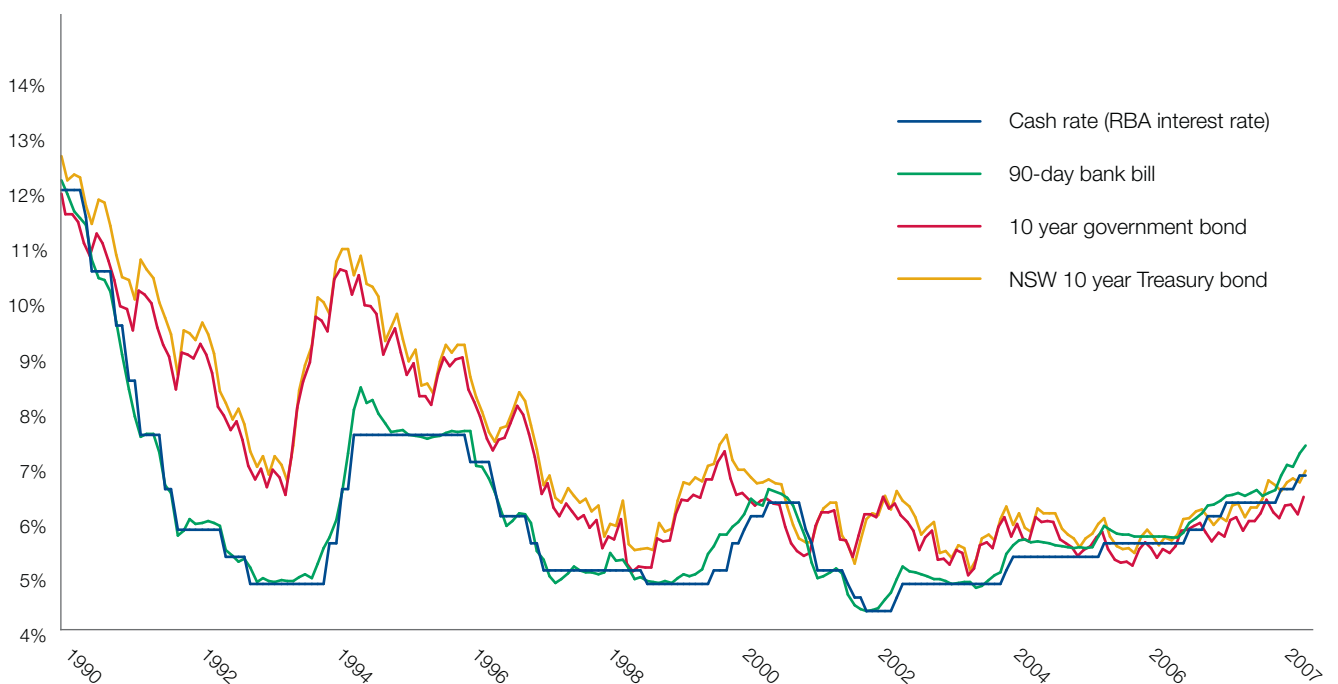
Consistent with the decline in inflation, interest rates have also fallen sharply in Australia since the late 1980s.

For assets such as cash and government debt, low interest rates equals low returns.

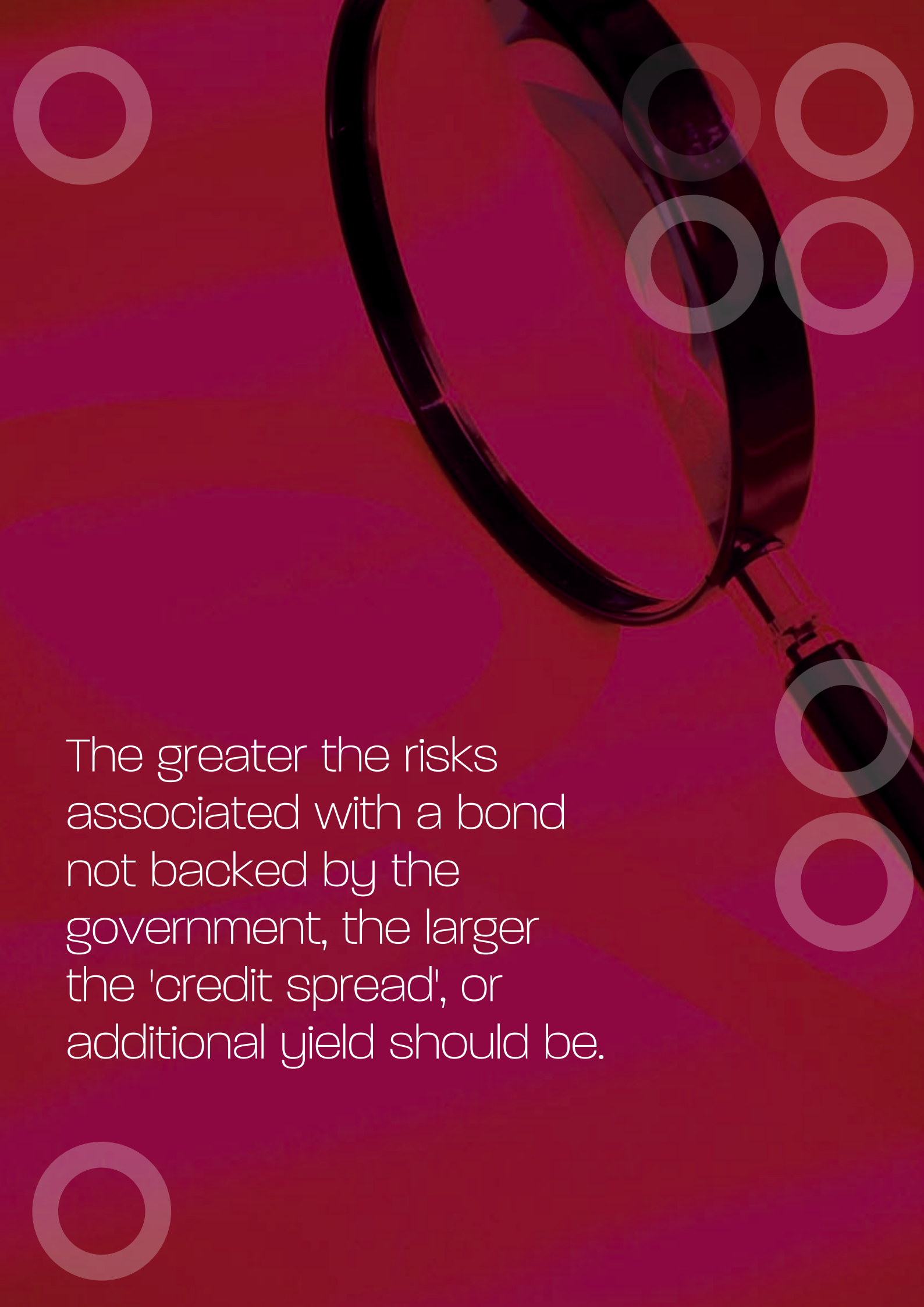
As interest rates rise, bonds are exposed to potential capital losses. Rising interest rates can also have a negative impact on shares. This is because increased borrowing costs can cause a decrease in a company's earnings, causing a fall in its share price.

Figure 6 shows the movements of Australian interest rates since 1990.

Figure 6 – Australian interest rates



Source: RBA Bulletin Tables F1 and F2 as at 31 December 2007.



The greater the risks associated with a bond not backed by the government, the larger the 'credit spread', or additional yield should be.

Focus on the credit market

In the current low interest rate environment there has been a steady decline in returns from traditional income investments such as bank bills and government bonds. There is increased demand for higher returning assets such as corporate debt. This demand in the past has fuelled growth in the Australian credit market which now represents over 40% of the Australian fixed income market.

Australia's growing credit market

The Australian credit market has experienced tremendous growth over the past 10 years (Figure 7). There are now hundreds of individual credit securities on issue in the Australian market in the form of corporate bonds, floating rate notes, mortgage-backed securities, income securities, hybrids and CDOs.

They have a wide range of ratings and yields because the financial health of the credit issuers can vary significantly.

What is a credit spread?

Government bonds are considered to be risk-free securities. On the other hand, non-government bonds (corporate bonds) carry the risk that the issuer of the security may not repay the principal or make interest payments.

For investors who own non-government bonds, a credit spread above the risk-free rate is paid to compensate them for taking on the risks of owning them. The risk-free rate refers to the rates on government bonds.

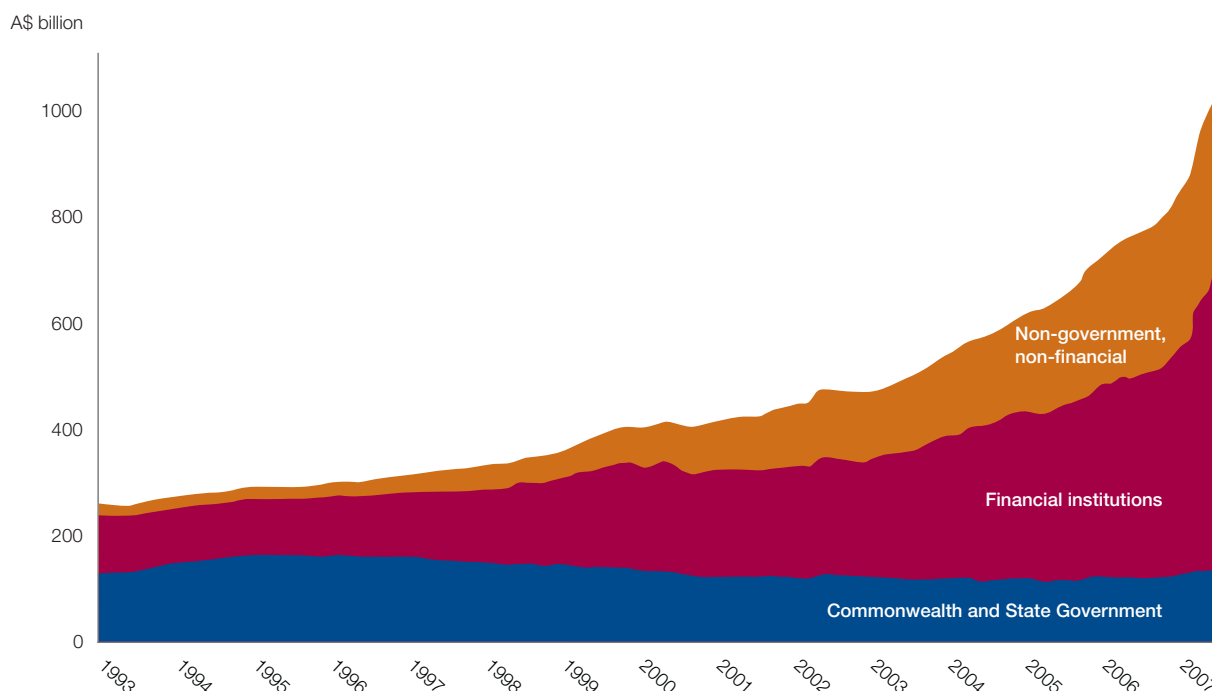
The credit spread is calculated as the difference in the yield between a non-government security and the government security with the same or similar maturity. The greater the risks associated with non-government bonds, the larger the credit spreads that **should** be required by an investor to purchase it.

What is credit spread?

A credit spread is the difference between a security's yield and the risk-free interest rate. This is received by investors in compensation for bearing risk. When it widens, investors experience price declines in their securities.

Figure 7 – Australia's growing credit market

As at 31 December 2007



Source: Reserve Bank of Australia Bulletin Table D4

History of credit spreads

In recent years the market and economic environment has been very supportive for debt-based assets. Interest rates have fallen and remained at low long-term levels. In order to increase returns in this environment investors have taken on higher risk made possible by low funding costs.

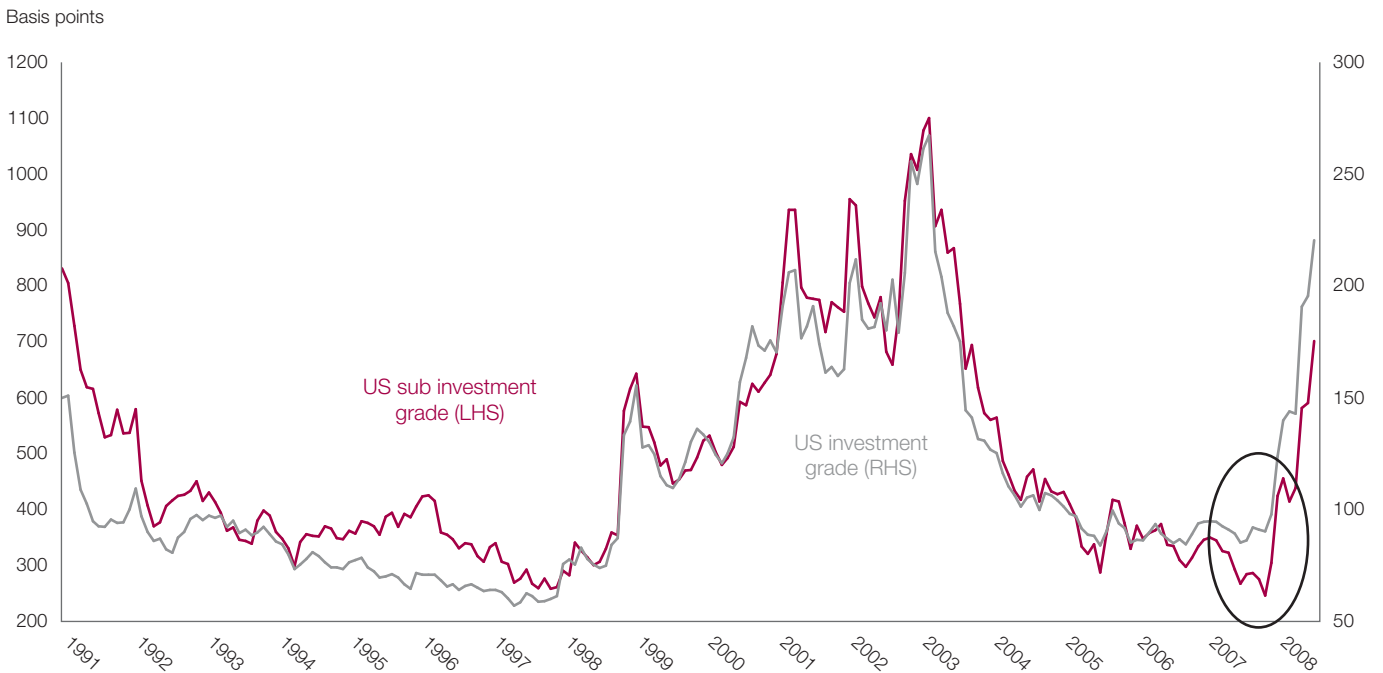
As credit spreads narrow towards zero, the balance of risk is increasingly skewed in one direction – against the investor. Figure 8 shows US credit spreads to government bonds, with credit spreads for both higher risk, higher return US sub investment grade and higher rates US investment grade securities narrowing from 2002 to mid 2007.

However, credit spreads began to increase again in late 2007. This is due to:

- the continued poor performance of the US housing market, affecting global financial markets
- an increase in actual and expected losses to be reported by banks and financial companies as a result of rising bad loans
- more ratings downgrades and a negative outlook for insurance companies (especially global financial guaranty insurers)
- an expectation that the US economy will go into recession
- high liquidity premiums attached to credit.

In other words, the expected return of these securities is now higher reflecting increased risk.

Figure 8 – Credit spreads have increased recently
US credit spreads to government bonds (basis points)



Source: Citigroup and Merrill Lynch as at 1 February 2008.

The asymmetrical nature of the credit market

When you invest in shares the investment risk is symmetrical. While you may lose, you also have the potential for larger gains.

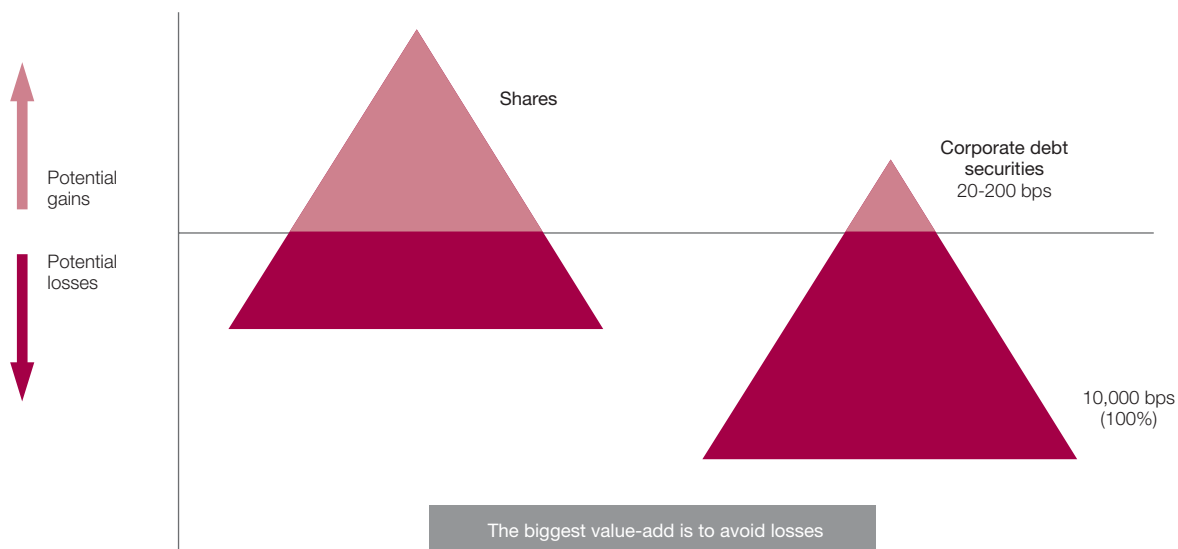
Credit risk, however, is asymmetric (Figure 9). The very best outcome is that the issuer will return what it is obliged to pay – your coupon and principal at maturity. The coupon is your return, which in the case of credit securities, may be 20-200 basis points above the risk-free rate.

On the downside, if the issuer defaults you could lose your entire principal. To put it in the same context this is equal to 10,000 basis points (ie 100%).

The biggest value-add in credit is therefore firstly to avoid losses. If you can avoid losses, you can then capture the returns available in credit.

It's important to remember that default is real. It happens continuously, even in favourable credit environments.

Figure 9 – The asymmetrical nature of the credit market (limited upside, big downside)



Source: Perpetual

The background is a collage of Australian 50 dollar banknotes, tilted at an angle. A semi-transparent yellow overlay covers the entire image. In the top left, there are three overlapping white circles. In the top right, there is one white circle. In the bottom right, there are two overlapping white circles. The text is centered in the lower-left quadrant.

As an interest rate security's rating decreases, you should look for a higher return to compensate for the increased investment risk.

Credit ratings

What are credit ratings?

Credit ratings help investors compare the relative risks of investing in different credit securities. The main risk of investing in these assets is that the issuer of the security defaults, ie does not repay the principal or make interest repayments.

Agencies such as Fitch or Standard & Poor's (S&P) evaluate corporate debt rate securities for credit quality. It's a good idea to check the ratings of interest rate securities before buying them. Figure 10 outlines S&P's credit rating system.

Figure 10 – S&P's credit rating system

	Rating	What it means
Investment grade	AAA	Highest credit quality
	AA	Very high credit quality
	A	High credit quality
	BBB	Good credit quality
Non-investment grade	BB	Speculative
	B	Highly speculative
	CCC	High default risk
	C	High default risk
	D	Default

Source: Australian Stock Exchange (ASX) website

As an interest rate security's rating decreases, you should look for a higher return to compensate for the increased investment risk. It's also important to keep in mind that ratings can change over the life of an interest rate security. Any change in the rating of a company would normally have a direct impact on the market price of its securities.

If a company is unrated, it does not necessarily mean that its bonds are high risk, but it does mean that investors will have to look at other ways to evaluate its financial strength.

Figure 11 shows that the lower the credit rating, the higher the risk of default over time.

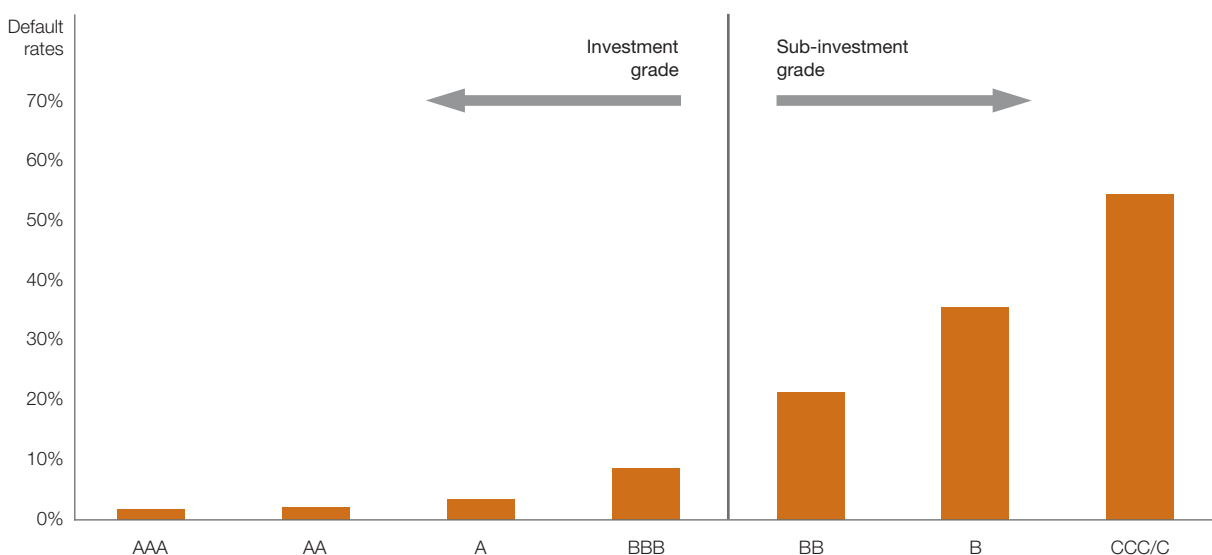
In particular, over a 15-year period the default probability of a AAA rated security is around 1%, whereas the probability of a BBB security defaulting is 8%, and a CCC/C security is over 54%.

The increased default risk is often not correctly priced, meaning increasing return does not always compensate for increasing risk. And as the default probability rises, so too does the uncertainty of return, which you can never diversify away completely anyway.


Figure 11 – Risk is the starting point, not the return

15-year cumulative average default rates (%)

Standard & Poor's survey of rated corporate obligations (1981-2006)



Source: Standard & Poor's



While everyone
focuses on default
risk, liquidity is often
very underpriced.

Why is liquidity important?

Liquidity is the degree to which an asset or security can be bought or sold in the market without affecting the asset's price.


There are two measures of liquidity:

1. Can the asset be sold quickly or when required?
2. Can the asset be sold at a reasonable/the right price?

While everyone focuses on default risk, liquidity is often very underpriced. One of the reasons for this is that most securities appear liquid in good market conditions and it is not until periods of market stress that the good is sorted from the bad. In these conditions, liquidity can be hard to find because demand falls and there is no one to sell to. If forced to sell, then it may have to be at a substantial discount.

Liquidity varies between securities and at different points in time. When the security is issued, there can often be great demand, but it can then be hard to sell down the track.

Liquidity doesn't seem important until you don't have it.

The background is a vibrant blue sky with soft, white, fluffy clouds. On the right side, a large, vertical cloud formation stretches from the top to the bottom. Scattered across the sky are several light blue, semi-transparent circular graphic elements. On the left side, there is a vertical column of three circles. In the upper right, there is one circle. In the center, there is one circle. In the lower right, there is one circle. The overall aesthetic is clean and modern.

Without transparency it becomes hard to establish how much risk you are taking on and how much compensation you need for that risk.

Why is transparency important?

It is important for the security you are buying to be transparent. Before you invest in something you should properly understand it.

Often, as risk increases, the securities that you buy become less transparent, ie more structured, more subordinated and are often small issues by minor corporations.

Without transparency it becomes hard to establish how much risk you are taking on and how much compensation you need for that risk. Investors tend to skip over this in good times and suffer for it in bad times.

Some issues to consider are:

- whether or not the issue has been rated by a ratings agency (such as Standard & Poor's) which would mean it has undergone thorough financial analysis and is monitored on an ongoing basis
- whether or not it has been issued by a publicly listed company which makes it subject to financial scrutiny by analysts, investors and media and is required to provide continuous, transparent disclosure on its financial and operating condition
- what the type of instrument is like – for example, vanilla bonds are more transparent and easily understood than more exotic types of debt instruments.

For example, a five-year fixed rate bond issued by a major Australian listed bank is a lot more transparent than a 25-year inflation linked bond issued by an unrated private infrastructure company.

If you cannot properly understand a security, stay away.

Is the risk worth the reward?

When investing in income securities you need to ask:

- am I taking on a higher chance of losing my capital by selecting an income investment based on yield only?
- is it possible to get a similar return for less risk?

The problem with the risk and reward trade off is that you often can't see the full picture. Investors often underestimate risk and overestimate returns.

Take hybrid securities for example. The first major issue in Australia was in 1999 by National Australia Bank (NAB) of \$2 billion of income securities. Since this time some \$25 billion has been raised via more than 180 issues.

The typical characteristics of hybrids are that they are both debt-like and equity-like. They are debt-like in that they pay a coupon based on a margin above a reference rate and are often deeply subordinated to other company debt. They are equity-like because the coupon is often payable at the issuer's discretion, are often convertible into company shares, may pass on franked dividends and are traded on the stock market.

Essentially hybrids seem simple. You can buy them via a broker, thinking you have a well diversified portfolio of income assets backed by strong blue chip companies. However, hybrids are not simple. Each issue has its own conditions and risks which can greatly affect your return.



Diversifying your
investments can help
reduce both the risk
and the volatility of
investment returns.

The importance of diversification

How do you deal with risks while at the same time maximising returns? One of the answers is diversification. Diversifying your investments can help reduce both risk and the volatility of investment returns.

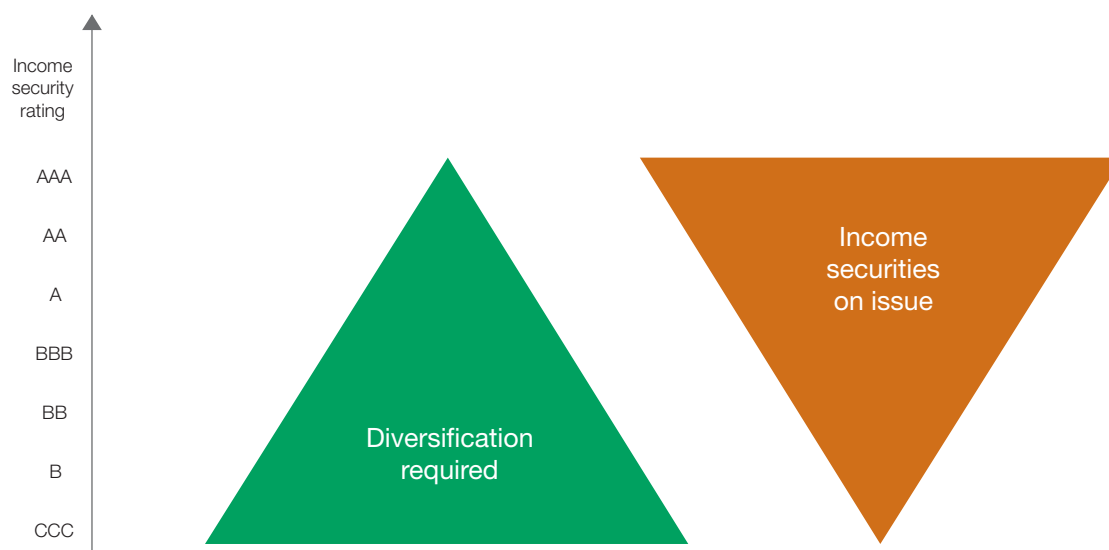
One of the most effective methods of diversification is to spread your money across a range of high- and low-risk investments.

Diversification becomes more essential the riskier the security. However there are actually fewer lower quality securities available to allow you to diversify risk. This is shown in Figure 12.


And because of the asymmetry of risk in credit markets – where you can lose more than you can make – the need for diversification is much higher than in a share fund. For example, you may have efficient diversification in a share portfolio with 15 stocks. You would need more than 100 credit securities to have that same level of comfort.

It is also important to remember that diversification doesn't mean buying lots of securities with the same risk. It means buying lots of assets with quite different risks – if you have a portfolio full of hybrids you are not really diversifying.

Figure 12 – Diversification and security quality



Source: Perpetual



We believe the key
to delivering quality
income-based funds
is to provide good
levels of diversification
with strong liquidity.

Perpetual's income funds

Focus on quality

We believe the key to delivering quality income-based funds is to provide good levels of diversification with strong liquidity. Diversification minimises the impact of default and liquidity reduces risk in periods of uncertainty. Portfolios will be driven by core liquid holdings with investments in higher income-producing assets only made when market conditions are suitable.

To maximise the benefits of diversification, we have proven asset management teams in credit, property securities, and mortgage lending. These teams complement our existing domestic and global equities teams.

Our income funds include:

- Perpetual's Diversified Income Fund
- Perpetual's Monthly Income Fund
- Perpetual's Property Securities Fund
- Perpetual's Property Income Fund
- Perpetual's Term Fund
- Perpetual's Cash Management Fund

Perpetual's Diversified Income Fund

If you're looking for regular income, consistent returns, and a fund that invests in a diverse range of income generating assets and that can gear, Perpetual's Diversified Income Fund may suit you.

The Fund has a unique investment structure which aims to provide investors with income from a core portfolio consisting of high quality, income-producing assets such as cash, fixed interest and listed hybrid securities.

The core portfolio is opportunistically enhanced by the plus portfolio which generates higher returns by accessing Perpetual's specialist knowledge across other income-focused asset classes. This broad skill set enables investors to potentially benefit from exposure to higher-yielding securities such as first-registered mortgages, mezzanine mortgages, private debt and other income-generating assets.

The Fund may borrow (gear) up to 66.7% of the core portfolio, providing fundamental and market conditions are suitable.

The broader investment universe provides the opportunity for investors to experience some protection against negative returns in tough investment conditions as well as for higher returns during opportunistic periods of the economic cycle.

Please refer to the relevant PDS for the risks of investing in this fund.

Figure 13 – Perpetual's Wholesale Diversified Income Fund performance

Returns as at 31 December 2007*	
6 months	-0.9%
1 year	2.1%
2 years	4.7%

Past performance is not indicative of future performance.

Perpetual's Monthly Income Fund

If you're looking for stable and reliable income from the secure investment environment of mortgages and cash, Perpetual's Monthly Income Fund may suit you.

The Fund is one of the longest running mortgage funds in Australia. The Fund aims to provide a secure rate of return through exposure to quality first-registered mortgages and investment in deposits, money market and fixed interest securities.

Figure 14 – Perpetual's Wholesale Monthly Income Fund performance

Returns as at 31 December 2007*	Growth	Distribution	Total
1 year	0.0%	6.2%	6.2%
3 years	0.0% pa	6.2% pa	6.2% pa
5 years	0.0% pa	5.9% pa	5.9% pa

Past performance is not indicative of future performance.

The background is a solid orange color. There are several decorative elements consisting of concentric circles. On the left side, there are two circles stacked vertically. On the right side, there are two columns of circles. The top column has three circles, and the bottom column has two circles. All circles are a lighter shade of orange than the background.

We have a range of
retail and wholesale
funds available.

Perpetual's Property Securities Fund

If you're looking for the potential for long-term capital growth, a stable income stream and a fund that invests in property related securities listed on the ASX, Perpetual's Property Securities Fund may suit you.

The Fund invests in property trusts (including LPTs) and property-related companies that are managed by experienced property professionals with a proven ability to deliver results with their investment strategies. The Fund provides investors with a portfolio consisting of retail, industrial, office, commercial and residential property.

Figure 15 – Perpetual's Wholesale Property Securities Fund performance

Returns as at 31 December 2007*	Growth	Distribution	Total
1 year	-18.8%	8.6%	-10.2%
3 years	2.2% pa	8.8% pa	11.0% pa
5 years	4.9% pa	9.2% pa	14.1% pa

Past performance is not indicative of future performance.

Perpetual's Property Income Fund

If you're looking for diversification within the property component of your portfolio, or investment returns more closely correlated to those of real property than an investment in listed property trusts alone, Perpetual's Property Income Fund may suit you.

The Fund aims to provide investors with stable income and long-term capital growth by investing in both listed and unlisted property. The Fund seeks to identify trusts and direct property assets that have attractive growth potential, have quality assets that are reasonably priced, exhibit sound capital management strategies and are managed by experienced professionals with proven ability.

Figure 16 – Perpetual's Wholesale Property Income Fund performance

Returns as at 31 December 2007*	Growth	Distribution	Total
1 year	-5.0%	6.4%	1.4%
2 years	4.6% pa	7.7% pa	12.3% pa
3 years	5.2% pa	7.5% pa	12.7% pa

Past performance is not indicative of future performance.

Perpetual's Term Fund

Perpetual's Term Fund offers you an attractive return with an income to help support the lifestyle you enjoy. The Fund offers a variety of terms, all with attractive returns. For most recent returns, visit www.perpetual.com.au or phone us on **1800 022 033**.

Perpetual's Cash Management Fund

This Fund aims to give you security of capital and regular income at competitive interest rates through investment in deposits, money market and fixed interest securities that we consider to have a very low risk of capital loss.

This Fund may suit investors looking for a secure investment that pays regular income.

Figure 17 – Perpetual's Cash Management Fund performance

Total returns as at 31 December 2007*	
1 year	5.6%
3 years	5.1% pa
5 years	4.7% pa

Past performance is not indicative of future performance.

For more information or for up-to-date returns visit our website www.perpetual.com.au or phone us on **1800 022 033**.

* Total returns have been calculated using the exit prices after taking into account all of Perpetual's ongoing fees and assuming re-investment of distributions. No allowance has been made for taxation. The distribution return comprises of income and any realised net capital gains distributed to investors. The growth return is the unrealised net capital gains accrued by a Fund and any income and realised net capital gains that have not yet been distributed. Returns for the Perpetual Funds accessed through Investor Choice, WealthFocus Investments, Super, Pension Plans and Pooled Superannuation Trust will differ due to different fee structures and taxation treatment for superannuation. Past performance is not indicative of future performance. The PDS for the funds, issued by PIML, should be considered before deciding whether to acquire or hold units in the fund. The PDS can be obtained by phoning 1800 022 033 or visiting our website www.perpetual.com.au.



We aim to help
Australians secure
their financial
independence and
grow their wealth
from generation
to generation.

About Perpetual Investments

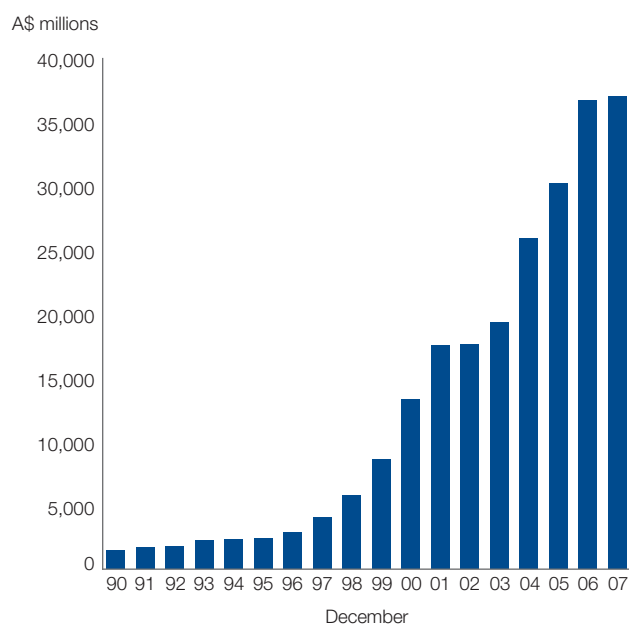
Perpetual Investments is one of Australia's leading funds management companies, with \$32 billion under management (as at 31 March 2008).

We employ some of the industry's best investment specialists and combine their expertise with a proven investment philosophy to provide consistent performance across a range of managed investments.

Perpetual Investments is the business name of Perpetual Investment Management Limited, which is a wholly owned subsidiary of Perpetual Limited. The aim of the Perpetual Group, which includes Perpetual Limited and its subsidiaries, is to help Australians secure their financial independence and grow their wealth from generation to generation.

We offer a selection of managed funds to suit most investors' risk profiles, investment timeframes and income and capital growth requirements. Our products invest across a range of asset classes including Australian and international shares, property securities, direct property, credit, infrastructure, fixed interest, cash, diversified asset classes and a range of superannuation and pension investments. We also offer a range of wholesale products for investors with more than \$50,000 to invest.

Figure 18 – Perpetual's funds under management



Source: Perpetual

Our investment approach by asset class

Credit

Our credit team has a tried and tested investment philosophy which focuses on identifying quality securities and investments that are attractively valued. In this way, the team manages fixed income portfolios in a similar way to our well-established and highly successful Australian equities team. Our credit team seeks to invest in a diversified range of high quality income-generating securities, which our systematic investment process identifies as having strong credit quality and attractive value relative to the investment universe.

Mortgages

Our investment approach to mortgages is to gain exposure to quality first-registered mortgages, generally with three-year terms, held over freehold and leasehold lands and buildings throughout Australian capital cities and major regional centres. Our diversified funds also gain exposure to second-registered mortgages.

Property

We aim to add value through seeking quality properties and property securities with strong management and good growth prospects that are reasonably priced. We identify these opportunities with thorough in-house research, and an investment process that is disciplined in the assessment of quality and value.

We seek to identify listed property trusts that represent good value and have attractive growth potential, own quality assets, exhibit sound capital management strategies and are managed by experienced professionals with proven ability. We do not rely solely on quantitative valuation measures but also take into account qualitative factors such as management teams, distribution and earnings growth, quality portfolios and capital management.

Australian shares

We select shares on the basis of stock-specific fundamentals and then by the relative value of the shares. This is commonly referred to as 'bottom-up' investment management.

Our analysts research companies of all sizes using consistent share selection criteria. Our priority is to select those companies with the best investment quality that are appropriately priced. To be included in our portfolios, companies must pass the following share selection criteria:

- **Conservative debt levels.** Although companies with high debt levels are often favoured during sharemarket booms, these companies are often the first to be adversely affected during economic slowdowns. Our focus on minimising risk restricts such companies from being included in the Funds' investment portfolios.
- **Sound management.** We search for companies that are managed by experienced, clearly focused and prudent people.
- **Quality business.** To identify quality businesses, we assess a company's ability to produce established products and services, the nature of the industry sector in which the company operates, the company's market share and competitive factors such as barriers to entry.
- **Recurring earnings (in the case of industrial companies).** Although most companies' earnings are sensitive to economic cycles, we seek to invest in companies which are considered likely to produce a recurring income stream given normal operating conditions.

If a company possesses these qualities, it then enters our 'universe' of stocks for valuation. Typically, valuations are based on price/earnings (P/E) ratios, cash flow multiples and peer group comparisons. Having passed our quality filters and being found to be undervalued, the company will more than likely form part of our portfolios. The company will then be monitored to ensure it continues to meet our quality filters.

International shares

The international share investment team adopts a very similar investment philosophy to our successful Australian equities team, focusing on quality stocks that offer value. Our global equities investment process follows four key stages:

- **Idea generation.** Investment ideas and research are conducted on a team basis, which helps to reduce 'key man' risk and allows the team to make every available use of cross border analysis.
- **Quality assessment.** Perpetual's International Share Fund invests in established, quality companies with a proven track record and strong balance sheets. These companies tend to be industry leaders and global brands that have strong franchises.

- **Valuation analysis.** If a stock passes the quality tests, this does not mean that it is automatically included in the portfolio. It must also be attractively valued using fundamental valuation measures. The team's consistent investment approach ensures they don't get caught up in short-term trends or cycles.
- **Portfolio construction.** Investment decisions are also made on a team basis, meaning each stock in the Fund is 'owned' by the entire team. We have a benchmark-independent philosophy which aims to strike the right balance between portfolio concentration and diversification. The fund managers apply a long-term approach when investing, typically taking a three- to five-year view on companies. This helps the Fund minimise its turnover and transaction costs.

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